Pakistan’s Economy: Achievements, Progress, Constraints, and Prospects
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Introduction

Since independence, Pakistan can look back on 50 years of steady, sometimes spectacular economic advance:

- Pakistan’s growth has been the fastest in South Asia. On average gross national product has increased on average by over 5 percent a year since 1947.
- Pakistan started behind India at the time of independence, but is income per capita is now 75 percent higher.
- In spite of high population growth, per capita income has more than trebled in the past two decades.

Still, despite these accomplishments there is growing dissatisfaction with the country’s economic performance. Here the main shortcomings often cited include (Khan, 1997):

- large budgetary and balance of payments deficits,
- low savings and investment rates
- rising external debt and payments obligations
- increasing inflationary pressures,
- population explosion and rising unemployment,
- physical infrastructural constraints, and
- inadequate human resource development.

Pakistan golden jubilee presents an opportune time to examine the country’s economic performance during the last 50 years.

- How far has the economy progressed and at what cost?
- Is progress sustainable?
- What are the main limitations associated with the country’s development model?
- Is Pakistan on the verge of becoming an Asian Tiger?
- Ultimately, one has to address the question posed by Mahbub ul Haq (1997a) “Why are its people so poor when the economy has made such rapid progress”?
- A perhaps related question is whether and to what extent democracy can be sustained in light of the massive economic, and social difficulties the country currently faces (Monshipouri, 1995).

Overview

Characterics of the Country's development:

- The marked increase in Pakistan's GNP during the last 50 years was made possible though substantial increase in agricultural and industrial output (Ahmad, 1997).
- Production of all the major agricultural corps registered impressive increases during the last five decades.
- Production of wheat went up from 3.9 million tons in 1960 to 16.4million in 1997. Production of rice rose from about one million tons in 1960 to an estimated 4.3 million in 1997.
- Production of cotton moved up from 1.7 billion bales to 9.4 million, while production of sugarcane increased from 10.7 million tons to 42 million tons during the above period.
- As far as the manufacturing sector is concerned, Pakistan started almost from scratch. At the time of establishment of Pakistan, there were only one or two textile mills and cement plant in the country.
- During the last 50 years, not only have hundreds of textile mills been established, but food industries including vegetable thee and sugar mills, cigarette manufacturing units, cement plants an fertilizer factories have also been established in the country. Production of sugar went up from 81,000 tons in 1956 to about 2.5 million tons in 1997, whereas production of cement increased from 732,000 tons in 1956 to 9.6 million tons in 1997.
- Apart from the above-mentioned industries of a basic nature, Pakistan is entering the era of engineering and automotive industry, electrical and mechanical goods industry, steel, shipbuilding and pharmaceutical industry.
- Presently, the manufacturing sector accounts a share of 18 percent in the country's Gross Domestic Product (GDP) and this share may go up further when the engineering, automobile and other value added industries make a head-way in the coming years.

For many, the increase in Pakistan's GNP and per capita income resulting from the development of the country's agricultural and manufacturing sectors translates into improved living standards.

- The number of motor cars, jeeps and station wagons registered in Pakistan increased from 15,849 in 1950 to 923,577 in 1995.
- The number of telephone connections went up from 60,000 in 1960 to 2.4 million in 1997, whereas the availability of televisions sets increased from 92,000 in 1970 to 2.7 million in 1996.

On the negative side, it is clear that the country has achieved to little and what has been accomplished has been done at a very high cost.

- Despite the substantial increase in the production of major agricultural crops, the country has still not been able to achieve food self-sufficiency and has to spend about $2 billion annually on the import of wheat, edible oil and the like.
- As far as manufacturing is concerned, the country has yet to make a real break-through in engineering and other value added industries and is heavily dependent on imports to meet its requirements of machinery, electrical and mechanical goods, transport equipment, steel and chemicals.
- It is due to this fact that Pakistan's annual imports ($11.5 to $12 billion) exceed its annual imports (8.5 billion on average) by about $3 billion to 4 3.5 billion.
- As a result, Pakistan's external debt has mounted to an alarming $32 billion and in addition there is an internal debt of Rs. 1000 billion.
- Because of such a heavy debt liability, the allocation for debt servicing alone (Rs 249 billion) in the federal budget for 1997-98 constituted nearly 45 percent of the total outlay and the government had to cut down on its vital defense and development budgets in real terms.

Unfortunately, it seems that after 50 years of independence and economic planning, the country's fortunes still depend in large part on the country's cotton crop.

- More than half of the country's exports still consist of cotton products, mainly textiles and related materials. In the past three years, successive crop failures have increased the price of cotton in the domestic market and eroded the profits of the textiles sector.
- Export growth has been slow and both the international trade and current account deficits have swelled.

Even more importantly, the country has failed to develop its human capital. In this regard (ul-Haq, 1997a) Pakistan's economic growth is a puzzle because there is scant evidence that this economic advance has affected the lives of ordinary people. Indices of poverty and deprivation are so widespread and so stark that many skeptics have begun to doubt the reality of economic growth itself. The simple explanation is that fact growth has taken place but the prosperity it has produced has been very unevenly distributed (ul-Haq, 1997a).

- In 1960 about 19 million people lived below the poverty line in Pakistan. By 1980 the number of people defined by the government as absolutely poor had grown to 34 million.

- Poverty then fell by 10 million during the 1980s thanks to a bonanza of external remittances, largely from Pakistani workers in the Middle East.

- But, poverty has started increasing again alarmingly. In just vide years between 1990 and 1995 the number of absolute poor rose from 24 million to 42 million.

Summing up, the country appears to be at a crossroads. The predicament facing the government at the moment is that neither can it repay all of its debt and get out of the debt trap nor is the government left with enough money after making budget allocations for defense and debt servicing so as to spend on the development of the physical and social infrastructure.

The present Government is trying hard to retire part of the external and internal debt by speeding up its privatization program. Simultaneously, the authorities have has announced an economic reform package to boost the GDP growth rate and exports in the shortest possible time. One thing is clear. Whether the country will be able to revive its growth and retain the hope of becoming an Asian Tiger will depend largely on the good will of the International Monetary Fund and the country's major creditors.

Patterns of Economic Growth and Development

To gain a sense of how the country got in its current predicament, the following sections trace the economic history of the country. In particular we are interested in determining the factors that appear to have been responsible for periods of high growth as well as those associated with periods of relative decline. Based on this analysis several scenarios are developed for the period up to the year 2000.

Pre Ayub Years 1947-1957

Pakistan began its economic development in an environment of (Dhakan, 1996, 18):

- Pre-industrial institutions
- Low productivity
- Non-existance of an established manufacturing industry
- Uneven regional development
- High population growth

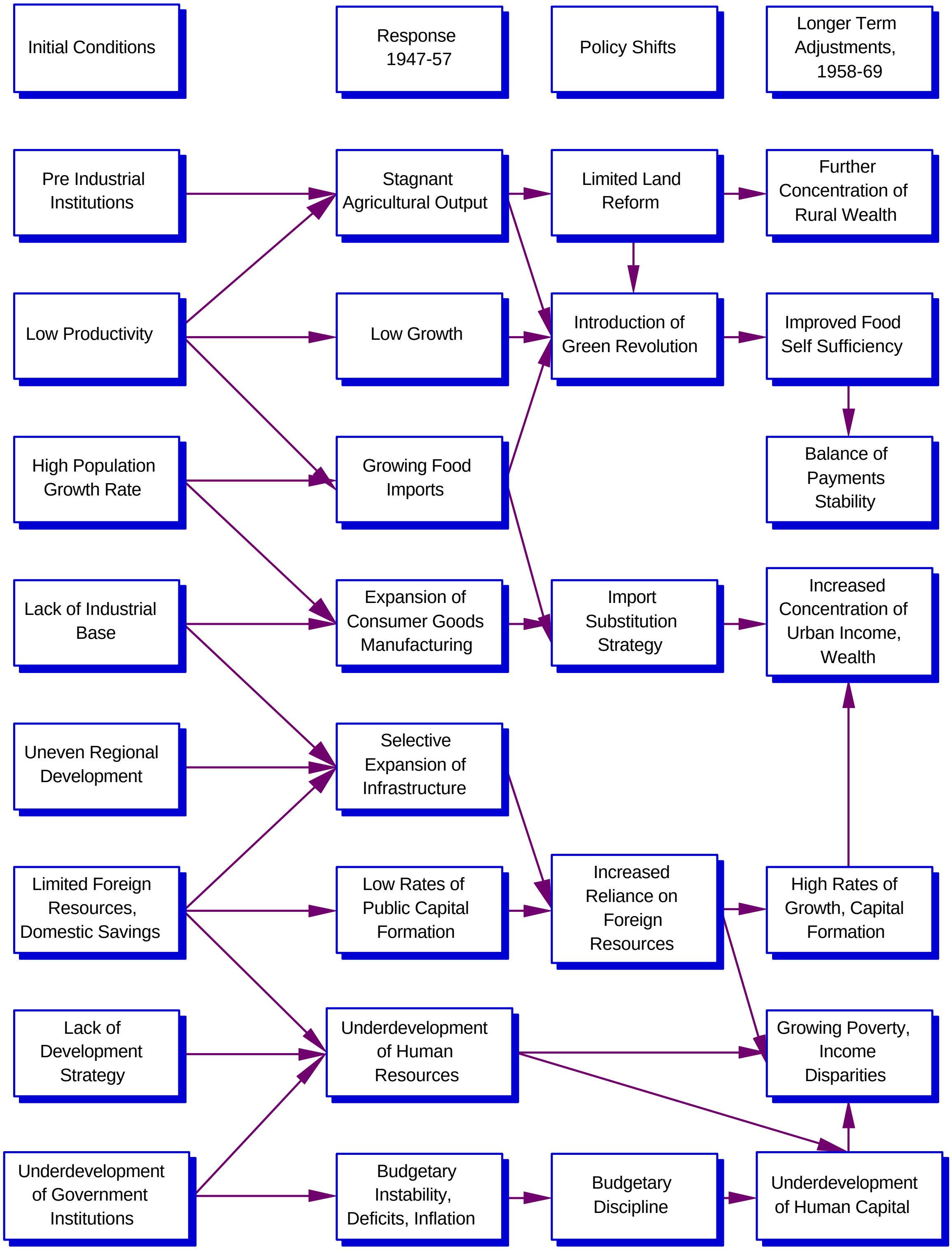
Despite these limitation, several key economic developments took place (Figure 1) during this period (Ahmed, 1984, 64):

- The most notable economic accomplishment was the rapid expansion of large-scale manufacturing. Although the average growth rate of 19.1 percent per annum must be interpreted with caution because of the very small base from which the economy started the achievements in the manufacturing sector were impressive and laid the foundation of a consumer goods industry. However there was a significant slowing down in growth during the last three years—1955 to 1957.

- Throughout the period the dominant sector of the economy, agriculture, stagnated and its growth was in fact even less than the growth in population, so that the per capita consumption of food grain declined and in many cases had to be supplemented through food imports.

- Because of little growth in the agricultural sector, the small share of manufacturing and the high growth rate of the population, the overall per capita income did not increase during this period.

Figure 1
Pakistan, Patterns of Growth and Collapse, 1947-1969



- There were, however, other important achievements which tend to be overlooked. The settlement of 7 million refugees, the setting up of the administrative machinery of government, the establishment of vital economic institutions like he State Bank, and other financial institutions were all achieved with considerable success during this period.

During this period there was no overall long-term development strategy being seriously implemented by the government. Still, an examination of the patterns of public an private investment does reveal the initial development of what were to become several of the country's longer term development priorities (Ahmed, 1984, 75).

- Investment in the industrial sector dominated the private sector investment.
- Investment in the agricultural sector was minimal compared with that in industry.
- Significant improvements were made in infrastructure development especially in the transport and communication sector. There was also substantial private sector investment in housing which was undertaken mainly by the higher income groups.

- Investment in the social sectors, i.e., education and health, were minimal and these sectors had a very low priority in the total development expenditure.

Ayub Administration (1958-1969)

This was a period of rapid economic growth averaging 5.4 percent annually. Given the rate of population growth this translated into an increase of per-capita incomes of 3.5%. Large-scale manufacturing grew at almost 17% annually. During this period, the Green Revolution provided a major stimulus to the agricultural sector.

There is considerable controversy regarding overall economic performance during the period (Ahmed, 1984, 77):

- For some, the sixties was one of considerable economic success.
- Those who take this position usually point to various economic indicators to prove their case.
- There usual defense is that the resulting economic problems and tensions were either exaggerated or were a "cost" one had to bear for rapid economic development.
- For others, the growth performance was exaggerated.
- Even worse they argue, this period of rapid economic growth generated a great deal of economic tensions: Regional and class inequalities increased, while large segments of the population experienced a falling standard of living.
- The concentration of incomes was particularly disturbing (Noman, 1988): Twenty-two families owned sixty-six percent of industry, ninety-seven percent of the insurance sector insurance sector and eighty percent of banking. Only 0.1 percent of landlords owned 500 acres or more, yet they owned 15 percent of the country's total land.

A. Bhutto Administration (1972-77)

The regime of Z.A. Bhutto was given the mandate to eradicate the class structures that economic growth had produced. Economic growth during this period was 4.3 percent per year. Large-scale manufacturing declined substantially growing at a rate of less than 2% annually compared with growth rates that exceeded 10% in the 1960s. There was a decline in per capita agricultural production. Industry and educational institutions were nationalized, the efficiency of industry declines, and people became disenchanted with the economy. The main events of this period are outlined in Figure 2).

Summing up this period is difficult, but several main failures patterns stand out (Ahmed, 1984, 98):

- This period represents a marked shift in the country's pattern of savings and investment away from the private sector towards public programs. More importantly the period experienced a pronounced fall in the over all rate of savings.

- The administration's economic and social development programs were over-ambitious with costs far exceeding the availability of domestic and foreign resources. By relying on deficit financing to meet the country's resource gap and by furthering inflation it squeezed the middle classes and they finally revolted against the regime.

- Critical to the success of the government's strategy was the achievement of high growth rates of agriculture and industry to cushion the long gestation of public sector programs. The failures of these sectors meant that there was very little grown of output from 1974-75 to 1976-77.

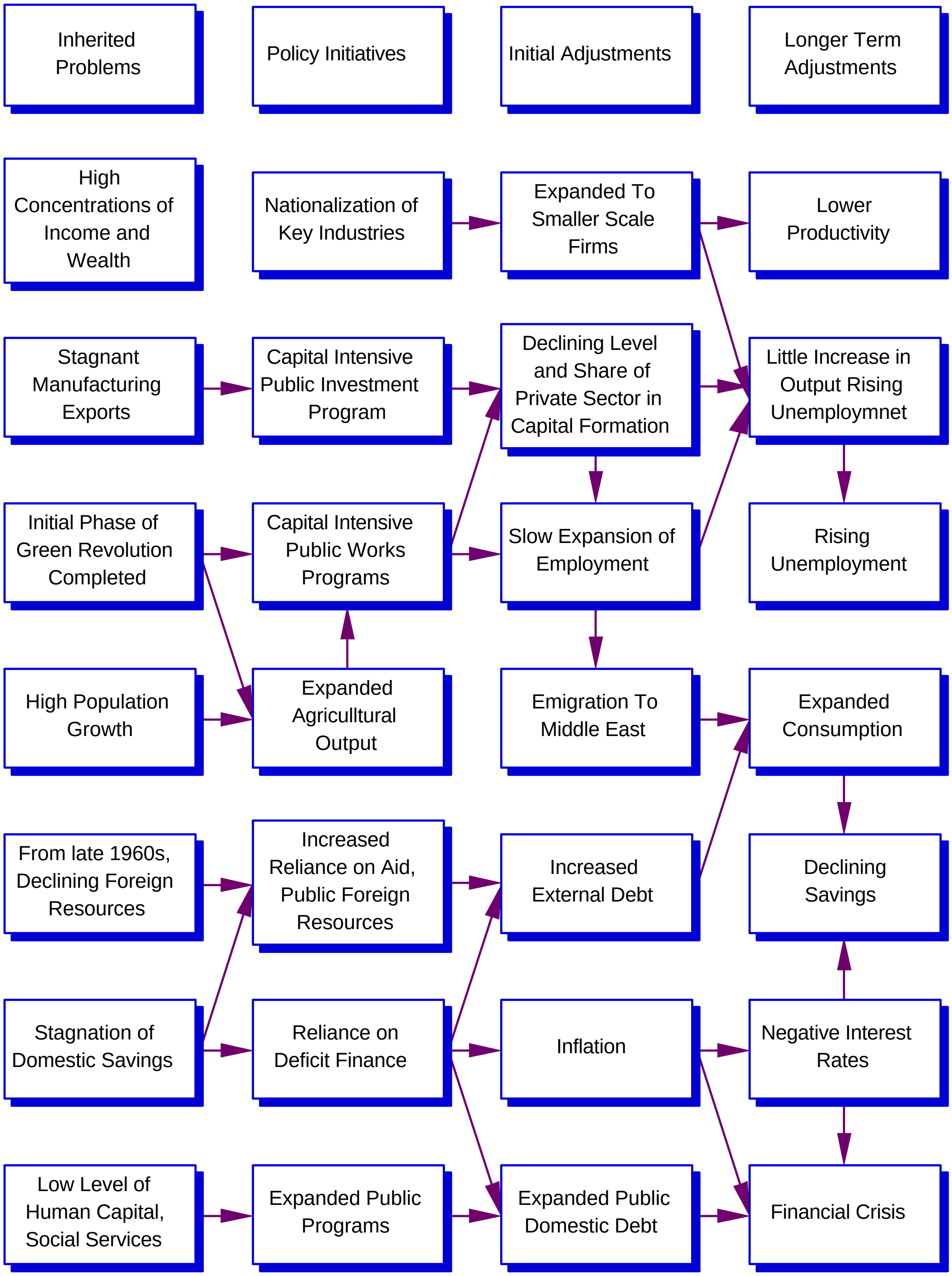
- The government's programs failed to generate much employment because the bulk of investment was in capital-intensive projects. However the employment situation was considerably improved by the large-scale emigration of the industrial labor force to the Middle East.

- The government failed to establish the ideology of state capitalism which it had initiated through the process of nationalization. It failed to establish a working relationship with the big monopoly houses which refused to invest throughout the period and preferred to invest abroad.

- The government exceeded its original policy of nationalization and began to nationalize industries other than those which had originally motivated the reform. This was especially true of the smaller units in the agro-based industries.

Figure 2

Pakistan, Transition Policies Under A.Z. Bhutto, 1972-1977



The result of the lack of private investment during this period was that the economy became caught in a double squeeze. High oil prices and increases in remittances from workers abroad led to inflationary pressures and with the private sector not investment, more funds were diverted towards consumption which further increased the demand pressures on the economy.

Zia Administration (1977-1988)

An interesting pattern that emerges when one looks at the economy is that Pakistan has generally not been in step with the other developing economies.

- This suggests that economic policy rather than external environment has played a much more significant role in shaping the course of development.
- Successive governments selfdom pursued the same set of objectives and seldom emphasized the same sectors of the economy.
- Consequently, there were sharp fluctuations in sectoral fortunes. Light manufacturing was the sector favored by the governments of the early 1950s, to be replaced by agriculture in the 1960s.

Although the Bhutto government was interested in increasing output, neither agriculture nor industry received sufficient attention to meet that objective. In the concluding years of the 1970s and early 1980s the government turned its attention once again to the development of the agricultural sector with a subsequent improvement in that sectors fortunes. In general, (Table 1):

- Pakistan has a service sector that is relatively large given its income and an industrial sector that is underdeveloped for its stage of development.
- With regard to demand, as noted the country's level of savings and investment are considerably below the norm for low-income countries.
- While public consumption and exports are more or less in line with countries of similar income levels, private consumption is considerably above the average for this group.

Economic growth accelerated under Zia.

- The average annual GDP growth rate was 6.3% during 1978-83.
- The manufacturing growth rate was 9%, substantially above the 3.8% average during 1972-78.
- All sectors except services and construction showed improved growth performance and from 1982-88 the economy grew at an even better pace: the GDP at an annual rate of 6.6% and large-scale manufacturing at an average annual rate of 16.6%.
- The economy clearly started to revitalize after the Bhutto government was overthrown.

Table 1
Comparative Evolution of the Structure of the Pakistani Economy

	1960	1965	1980	1990	1995
Composition of Output					
Agriculture					
Pakistan	46	40	30	26	26
Low Income	49	41	34	31	25
Middle Income	24	19	15	12	11
Industry					
Pakistan	16	20	15	25	24
Low Income	26	26	35	36	38
Middle Income	30	34	40	37	35
Services					
Pakistan	38	40	44	49	50
Low Income	25	32	29	35	35
Middle Income	46	46	45	50	52
Structure of Demand					
Public Consumption					
Pakistan	11	11	11	15	12
Low Income	8	9	11	11	12
Middle Income	11	11	14	14	14
Private Consumption					
Pakistan	84	76	83	73	73
Low Income	78	74	68	61	59
Middle Income	70	67	64	62	59
Gross Domestic Investment					
Pakistan	12	21	18	19	19
Low Income	19	19	25	31	32
Middle Income	20	21	27	23	25
Gross Domestic Savings					
Pakistan	5	13	6	12	16
Low Income	18	18	22	28	30
Middle Income	19	22	25	24	25
Exports					
Pakistan	8	8	13	16	16
Low Income	7	8	9	18	19
Middle Income	17	17	25	28	24

Source: World Bank, World Development Report, various issues.

Another economically and politically significant event was the flow of people to West Asia to find jobs.

- Approximately ten million people, 11% of the total population benefited directly from this exodus.
- Rough estimates are that from 1975 to 1985, Pakistan received a total of $25 billion in remittances from the workers in the Middle East, a good proportion of which went to the poorer segments of the population
- Another cause of the impressive growth during the Zia era was the large amount of foreign assistance coming to Pakistan. Assistant from the United States after 1982 totaled around $5billion, making Pakistan the third largest recipient of U.S. aid in the 1980s.

All and all however the eleven years of General Zia's rule represent an extraordinary missed economic opportunity (Figure 3).

- Just when generous levels of western aid were forthcoming, inflows of remittances from overseas Pakistani workers were also peaking.
- Between 1975 and 1985 Pakistan received $25 billion in remittances.
- Failure of the government to mobilize and direct a large share of these funds into infrastructure investment and improvements in education and health care meant a unique set of fortuitous factors yielded no durable economic dividends.
- Lack of investment in the infrastructure in rapidly growing cities like Karachi showed the seeds for crime, violence and ethnic tensions (Lodhi, 1997).

Despite its rapid growth the economy showed an increasing number of structural weaknesses toward the end of the Zia Administration. These included:

- heavy regulation of economic activity through price control, industrial licensing and Government ownership;
- a trade regime that provided a high level of protection and created distortions, thus inhibiting competitiveness and export growth;
- a weak public resource position due to a narrow and inelastic revenue base, high consumption expenditure, particularly defense, and inadequate development expenditure, resulting in an excessive budget deficit;
- an inefficient financial sector with mostly public ownership, directed credit, and weak commercial banks; and
- a high and growing debt service burden resulting from the country's heavy reliance on external borrowing to finance its economic growth in the 1980s.

The main reason many of these problems did not come to a head until the late 1980s was:

- the real interest rates on both external and domestic debt were substantially negative during the 1970s.
- However, real interest rates began turning positive during the 1980s. This development impacted quite adversely on Pakistan's debt situation.
- Consequently, the interest burden of the domestic and external debt began increasing significantly in the 1980s into the 1990s.

Figure 3

Pakistan's Economy Under Zia (1977-1988)

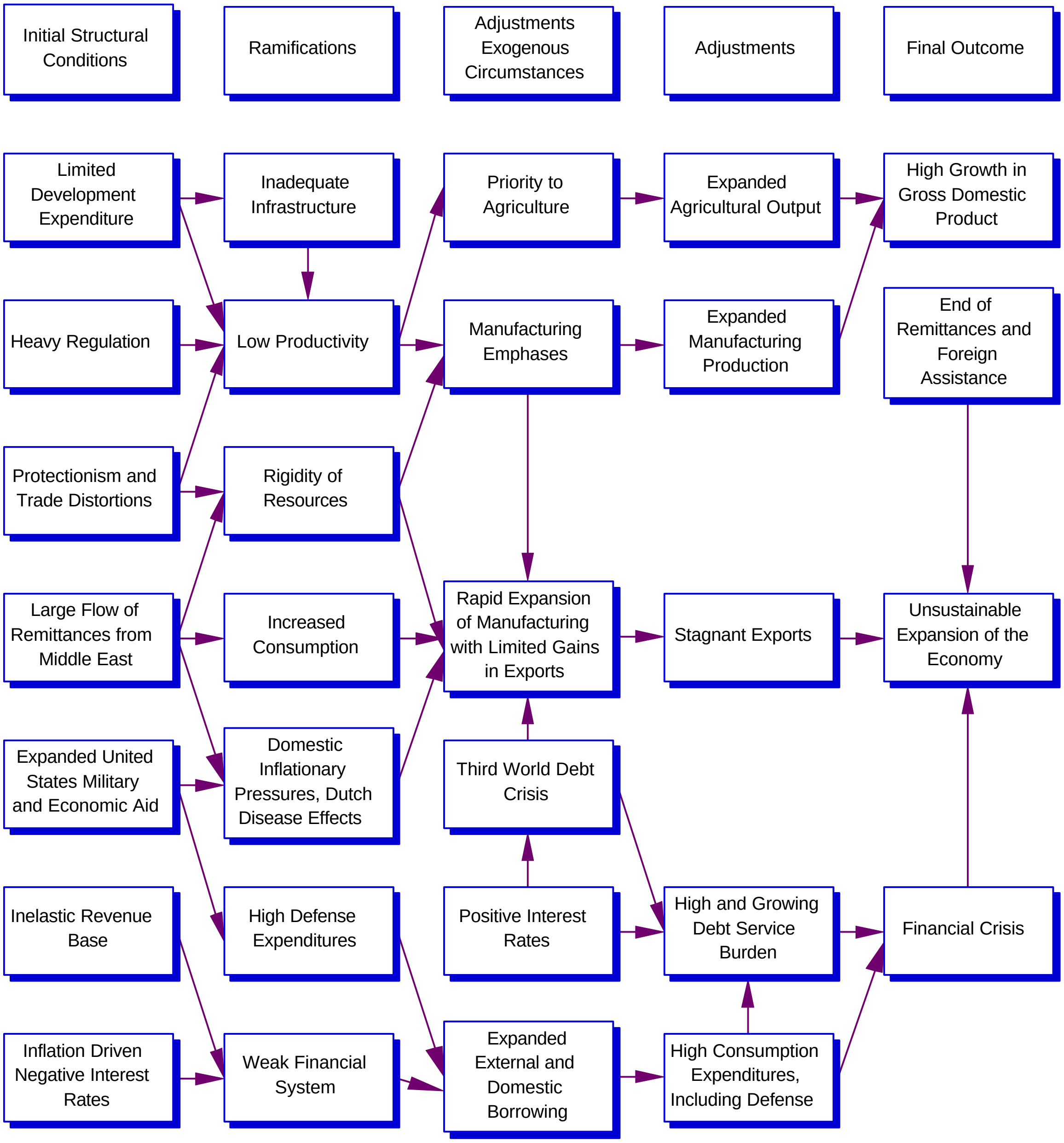
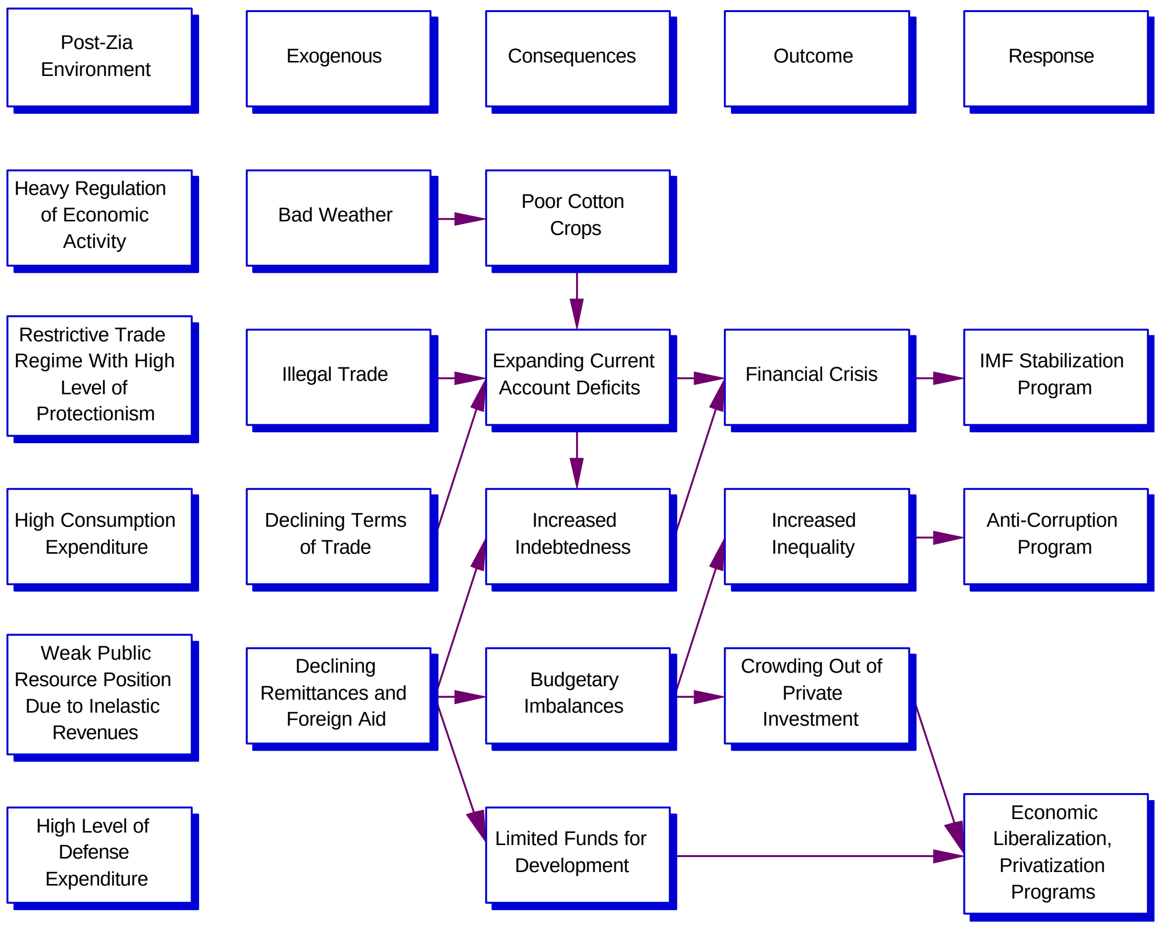


Figure 4

Economic Growth in the post-Zia Era



The Post-Zia Years

As an aftermath of the continuing resource scarcities that began to plague the country in the late 1980s, the government entered into agreements with the World Bank in the early 1980s and the IMF in the later part of the decade. The major emphasis of these agreements rested on the correction of prices and deregulation of trade. However latter agreements became all-inclusive as they involved structural and fiscal reform for deficit reduction, extensive trade liberalization and policy measures for reducing price distortions, deregulating production and investment for promoting efficiency of the system.

In large part the economy slowed because foreign channels of funding have gradually tried up. Foreign aid dwindled in the post-Cold War era and remittances from expatriate Pakistanis feel as the Gulf boom (of the 1970s and 80s came to an end. Unfortunately, private foreign direct investment has not picked up the slack. The strategy of Shariff's government has been to offset this reality with the potential for economic stimulus often associated with the increased economic freedom associated with his reform program.

Clearly, this approach is consistent with the growing literature stressing the association between economic freedom and economic performance. For example in "Economic Freedom of the World, 1975-95" Gwartney, Lawson and Block (1996) show a strong direct connection between economic freedom and economic well being. From the standpoint of basic economic theory, this result is entirely understandable: restrictions on economic freedom cause inefficiency, and result in sub-optimal levels of utility, personal income and the like.

Pakistan's summary economic freedom rating (Is1):

- improved from a very low 2.3 in 1975 to 5.4 in 1993-5.
- Most of the improvement came in the 1990s.
- In terms of the rankings Pakistan moved from 93rd in 1975 to 50th in the mid-1990s. The improvement in the country's economic freedom rating can be attributed to a few components in the index. First, top marginal tax rates have been reduced from 61% in 1975 (and 60% in 1985) to the current 38%.
- A significant liberalization of the exchange rate system has reduced the black market exchange rate premium from a high of 27% in 1980 to zero (and a rating of 10) in 1993-94.

Summing up,

- It is clear there has been a slight move toward economic liberalization in Pakistan over the last two decades.
- This improvement has allowed Pakistan to report modest, if unremarkable annual growth of per capita GDP of approximately 2.5%.
- For Pakistan to make the move into the modern market economy like Malaysia, Thailand, and Singapore, it must improve its regulatory environment that restricts citizens from holing bank accounts abroad, restricts prices and market entry, fails to treat citizens equally before the law, and interferes with the capital transactions with foreigners.
- the immediate impact of a change in economic freedom is likely to be small—particularly in the case of an expansion in freedom. The reason is simple, there will be a lag between the time when institutional arrangements and policies become more consistent with economic freedom and when they began to exert their primary impact on economic growth. Clearly, however through economic reform the government is laying the foundation for the restoration of strong economic expansion.

Figure 4

Economic Growth in the post-Zia Era

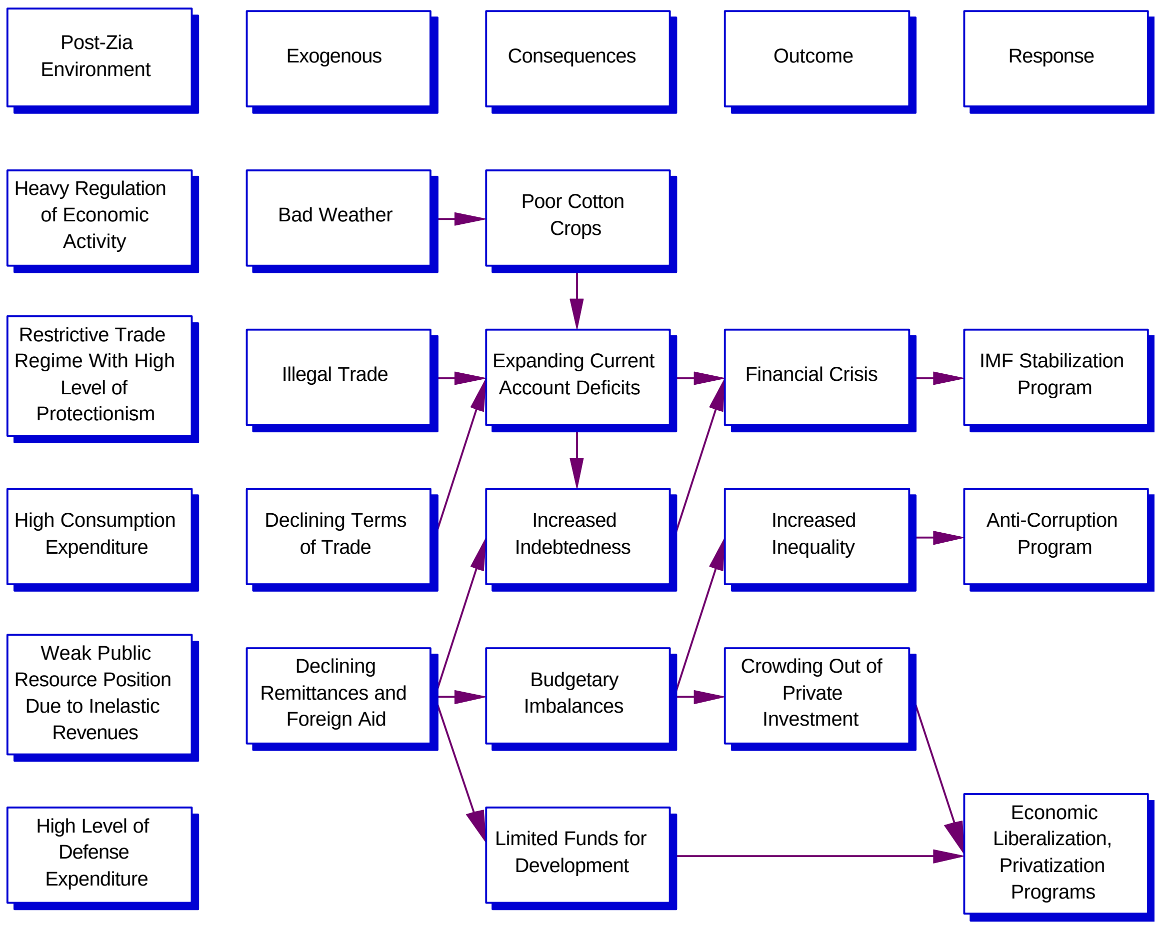


Table 2

Pakistan: Economic Freedom Ratings, Components and Summary Indexes

Components of Economic Freedom	**1975**	**1980**	**1985**	**1990**	**1993-5**
Money and Inflation	**1.9**	**3.6**	**4.8**	**6.1**	**5.8**
1. Annual Money Growth (last 5 years)	4	2	7	5	5
2. Inflation Variability (last 5 years)	2	9	8	8	7
3. Ownership of Foreign Currency	0	0	0	10	10
4. Maint. Of Bank Account Abroad	0	0	0	0	0
Government Operations	**4.9**	**5.2**	**5.2**	**4.8**	**4.6**
1. Govern. Consumption (%GDP)	8	8	7	5	7
2. Government Enterprises	2	2	2	4	4
3. Price Controls	-	-	-	-	4
4. Entry Into Business	-	-	-	-	5
5. Legal System	-	-	-	-	0
6. Avoidance of Neg. Interest Rates	-	6	8	6	8
Takings	**0.8**	**3.8**	**3.0**	**4.5**	**6.1**
Transfers and Subsidies (% GDP)	-	-	-	-	-
Marginal Tax Rates (Top Rate)	1	2	1	3	5
Conscription	0	10	10	10	10
International Sector	**2.3**	**2.0**	**3.0**	**2.3**	**6.1**
Taxes on International Trade (Avg.)	0	0	0	0	-
Black Market Exchange Rates (Prem.)	4	3	6	4	10
Size of Trade Sector (% GDP)	4	4	5	4	6
Capital Transactions With Foreigners	2	2	2	2	2
Summary Ratings					
Ie	2.4	3.6	4.2	4.5	5.3
Is1	2.3	3.5	3.9	4.2	5.4
Is2	1.9	3.2	4	4.3	5.0

Source: (Gwartney, 1996, 186)

N. Sharif 1997-

At the time Nawaz Sharif assumed power for the second time, Pakistan's economy had seldom before faced such a gloomy outlook . At the start of the new financial year in July, many analysis were forecasting that the country would for the first time default on its $39 billion foreign debt (largely due in December). Unexpected help from the IMF has averted that crisis, but the need for expanding and accelerating the reform program remains urgent (Bokhari, 1997):

- Servicing the burden of foreign and domestic debt during the current financial year (1997-98) is expected to absorb more than 40 percent of budgetary expenditure, the largest proportion ever devoted to debt servicing.

- An increasingly heavy debt burden has hardly been helped by meager economic growth. For the year ending in June 1996 the economy grew by only 3.1 percent. In a country where annual population growth is at least 3 percent that effectively amounts to a standstill.

- Other economic indicators were also bad. Large-scale manufacturing contracted for the first time in over 50 years, while agriculture which is the backbone of the economy and responsible for almost a quarter of GDP, brew only 0.7 percent.

- Pakistan's worsening international trade performance is among the most visible symbols of its economic malaise. The trade deficit for the year that ended in June hit a record high of $3.37 billion up from $3.1 billion the previous year.

Summary

Summing up, the country's growth experience suggests some important macroeconomic patterns and relationships that will be instrumental in affecting the country's future economic health.

- Highest growth (averaging 6.62 percent per annum) occurred during the 1980s. This was also a period of highest annual savings and the smallest resource gap (difference between savings and investment).

- Also during this period, Net Factor Payments, consisting largely of remittances, were by far their highest. This influx of funds allowed the country to have the highest ratio of imports to production (Gross Domestic Product) in its history.
- The lowest growth (averaging 3.69 percent per annum) occurred during the 1970s. During this period, investment's share of GDP reached a low of 16.4 percent, with savings only slightly above the low period of the 1960s.

- In terms of trends, savings have gradually increased over time from a low of 12.69 percent of GDP to 17.17 percent in the 1980s, only to decline slightly to 17.13 percent in the 1990s.

- Disregarding its decline in the 1970s, investment has also shown improvement over time, increasing from 16.83 percent in the 1960s to 19.49 percent in the 1990s. It should be noted however that both figures are very low by international standards, with the average saving and investment rates averaging in the mid-20s for low income countries and in the 30s for the South-East Asian Tigers.

- The country has gradually become integrated into the world economy as evidence by exports nearly doubling their share of GDP (from 8.69 percent in the 1960s to 16.31 percent in the 1990s). Imports have shown a similar steady increase over time averaging 12.9 percent in the 1960s and 19.98 percent in the 1990s.

As noted above, the different economic priorities and policies of various administrations (Table 3) have no doubt modified this pattern of (Table 4):

Table 3

Economic Performance Since Independence: Summary

Government	Strength	Weakness	Distinguishing Aspects
Pre-Ayub (1947-1957)	Rapid Expansion Large-Scale Manufacturing	Agricultural Stagnation	Neglect of Soccial Sectors
Ayub (1958-69)	Budgetary Stability	Limited Social Progress	Inward-Oriented High Growth
Z. Bhutrto (1971-1977)	Equity Concerns	Economic Decline Low Saving Rates	Nationalizations Private Sector Insecurity
Zia (1977-88)	High Growth	Limited Reforms Unstainable Policies	High Remittances/ Foreign Assistance
B. Bhuto (1988-90)	Attempt at Stabilization	Sluggish Growth	Democratic Distribution
Sharif (1990-93)	Privatization	Budget Stabilization	Economic Liberalization
B. Bhutto (1993-1997)	Continuation of Reforms	Budget Stabilization	Economic Mismanagement

Table 4
Pakistan: Macroeconomic Patterns by Administration, 1960-1995

Year	GDP	Savings	Invest	Gap	Exports	Imports	NFP	CurrAcc	Defen	Fiscal Bal
1960		9.17	16.32	-7.15	8.74	13.11	-0.13		4.36	-3.98
1961	0.00	12.22	16.18	-3.96	8.65	12.28	-0.17		4.15	-4.26
1962	6.03	11.67	16.32	-4.65	9.91	13.85	-0.32		3.73	-4.81
1963	7.68	12.09	19.12	-7.03	9.24	15.04	-0.44		3.80	-2.69
1964	5.26	11.93	19.03	-7.10	9.05	17.04	0.40		3.99	-1.59
1965	3.66	14.75	16.98	-2.22	8.81	12.03	2.47		6.19	-1.86
1966	7.26	15.44	16.41	-0.97	8.26	13.14	2.95		6.84	-5.58
1967	-4.34	13.65	16.08	-2.44	8.75	11.17	0.25		5.58	-1.47
1968	5.07	13.06	16.11	-3.05	7.88	10.96	0.02		5.22	-1.80
1969	5.39	12.93	15.80	-2.87	7.62	10.35	-0.13		5.42	-0.68
Ayub	4.00	12.69	16.83	-4.14	8.69	12.90	0.49		4.93	-2.87
1970	-2.47	13.06	15.80	-2.74	7.62	10.35	0.00	-7.03	6.23	0.22
1971	0.76	13.02	15.64	-2.62	7.76	10.54	0.16	-5.63	6.86	-1.28
1972	0.56	12.88	14.17	-1.30	7.25	8.75	0.18	-3.06	7.55	-3.20
1973	6.61	14.16	12.93	1.23	14.89	14.36	0.69	-1.96	7.02	-4.29
1974	5.72	10.35	13.37	-3.02	13.77	17.50	0.71	-6.23	6.83	-3.14
1975	4.52	9.29	16.23	-6.93	11.57	20.50	1.02	--10.36	6.69	-4.69
1976	4.67	14.83	18.22	-3.39	10.51	18.06	2.26	-7.09	6.14	-3.52
1977	3.74	14.42	19.27	-4.85	9.34	17.86	3.66	-7.02	6.04	-2.75
Bhutto	4.30	12.65	15.70	-3.05	11.22	16.17	1.42	-5.95	6.71	-3.60
1978	7.85	15.74	17.86	-2.12	9.43	18.48	6.88	-3.37	5.82	-3.19
1979	4.91	14.71	17.88	-3.16	11.03	21.80	7.45	-5.65	6.20	-3.45
1980	8.58	15.80	18.48	-2.68	12.57	23.27	7.79	-4.80	6.22	-1.27
1981	7.00	17.43	18.76	-1.33	12.84	22.33	8.16	-3.65	6.37	-2.89
1982	6.52	15.36	19.45	-4.09	10.28	21.33	7.89	-5.00	7.05	-1.55
1983	6.77	19.28	18.79	0.49	12.18	22.51	10.81	-1.78	7.39	-3.52
1984	5.15	17.14	18.27	-1.13	11.40	21.97	9.43	-3.20	7.31	-2.76
1985	7.55	14.41	18.32	-3.91	10.57	22.60	8.11	-5.41	6.76	-3.66
1986	5.51	18.99	18.76	0.23	12.29	20.11	8.04	-3.92	6.92	-3.24
1987	6.47	20.21	19.13	1.08	13.81	19.09	6.35	-2.18	7.21	-3.04
1988	7.61	16.75	18.01	-1.26	13.86	19.43	4.31	-4.37	6.96	-5.67
Zia	6.72	16.89	18.52	-1.63	11.84	21.17	7.75	-3.94	6.75	-3.11
1989	4.99	16.28	18.93	-2.65	14.07	20.35	3.64	-4.18	6.64	-6.25
1990	4.41	17.79	18.93	-1.14	14.79	20.24	4.31	-4.73	6.86	-3.30
1991	5.46	19.73	18.96	0.78	16.93	18.49	2.34	-4.76	6.33	-6.54
1992	7.83	18.03	20.15	-2.12	17.27	20.42	1.04	-2.75	6.26	-6.42
1993	1.91	15.35	20.70	-5.35	16.20	22.30	0.74	-7.12	6.52	-6.54
1994	3.77	16.50	19.52	-3.02	16.25	19.00	0.26	-3.78	6.00	-5.72
1995	4.48	16.55	18.71	-2.15	16.41	19.40	0.81		5.46	-3.81
Post Zia	4.69	17.18	19.41	-2.24	15.99	20.03	1.88	-4.66	6.29	-5.51

Notes: Compiled from International Monetary Fund, International Financial Statistics. All non-GDP variables defined as shares of GDP

- The Bhutto regime of the 1970s, experienced the lowest savings and investment rates, with the average rate of growth of 4.3 percent per annum only slightly above that of the 1960s.

- On the surface, economic performance was by far the best during the Zia regime, averaging over six and one half percent. However, a closer examination shows that this period was not characterized by a significant improvement in exports. Instead, the high level of imports was fueled largely by the fortuitous increase in remittances.

- The composition of consumption is consistent with this assessment. During the Zia administration, consumption was at an all time high, increasing to slightly over 90 percent of GDP. Despite a period of relative peace with India, defense expenditures also reached a high of 6.75 percent of GDP during the Zia years, with government expenditures increasing (19.54 percent of GDP vs. 16.73 percent) over that of the previous socialist regime.

- The figures on the composition of consumption also suggest that what ever gains the country has made in increasing savings has come about through the fall in private consumption. Public consumption has actually increased over time (from 9.59 percent of GDP during the Ayub years to nearly 14 percent in the post-zia period. Correspondingly, private consumption has fallen from slightly over 78 percent during Ayub’ s regime to 71 percent in the post Zia era.

- A more ominous trend is the general tendency for increased government expenditures to outrun revenue collection. Expenditures increased from 15.56 percent of GDP during the Ayub regime to 23.87 percent in the post-Zia period. Correspondingly revenues increased at a slower pace (from 12.69 percent to 18.36 percent), resulting an expanding deficit of 2.87 percent to 5.51 percent.

- Unfortunately, constant data on the composition of savings was not developed until the early 1970s. Still the observed patterns reinforce those noted earlier. In particular whatever success the county has had in increasing savings must be attribute exclusively to the private sector. Savings from this source has increased from 8.64 percent during the Bhutto regime of the 70s to 12.79 percent under Zia and up to 13.72 percent in the post Zia period. The corresponding figures for the public sector are 0.41, 1.80 and –0.25 percent.

- It is interesting to note that pubic investment has not changed much over time, increasing from 9.05 percent of gdp during A. Bhutto to 9.85 percent under Zia, falling to 8.62 percent in the post Zia regimes. Contrary to popular opinion private investment as a share of gdp was slightly higher under Bhutto (7.56%) than Zia (7.51%). This indices increased fairly dramatically to 9.26% percent during the post-Zia years.

- As noted, aid and remittances have fallen off considerably in recent years. Remittances reached a high of 45 percent of gross domestic investment under Zia. In the post-Zia years this figure has averaged only 21.44 percent.

- Increased current account deficits in an environment of falling aid and remittances has resulted in a fairly dramatic expansion in the country's external debt. Already fairly high by low and middle income country standards, Pakistan's external debt servicing as a share of exports increased from 18.3 percent in 1980 to 22.8 percent in 1990 and 35.3 percent by 1995. The corresponding figures for low income countries were 9.6, 20.1, and 15.4 percent.

Empirical Relationships

Several studies have attempted to quantify these relationships and in particular those factors that have contributed to the country's pattern of expansion (Figure 5).

Sources of Growth

With regard to the sources of growth (Ahmed, 1994):

1. Physical capital accumulation played a very important role in Pakistan's growth performance—overall and in the manufacturing sector. The fixed investment rate grew steady during the 1970s and then stabilized at around 17% of GDP in the mid-1980s. This allowed the capital stock, economy-wide and in the manufacturing sector, to expand fairly rapidly which in turn supported a substantial increase in the capital labor ratios and labor productivity.

2. Accumulation of labor also played a significant role in overall economic growth, but not to the extent of capital

3. Greater trade liberalization, as measured by the increase in the ratio of total value of exports and imports to GDP had a strong positive impact on Pakistan'' growth performance. Nevertheless, the strong positive role of greater trade openness suggests that Pakistan needs to continue with further trade reforms to enhance competition and economic efficiency.

4. The structural change variable included to capture the impact of the change in the policy regime in Pakistan from the interventionist policy regime of the 1972-78 period to the market-oriented economy since 1978 came up with a significant coefficient in the case of both aggregate and manufacturing sector growth equations. This result is explained by the major improvement in efficiency resulting from the reduction in controls and bureaucratic interventions. Estimates of total factor productivity (TFP) confirm this finding as well—TFP change was negative in the first period as compared with the positive contribution of TFP change to growth in the later period. Once again this reinforces the importance of further progress with economic liberalization.

Unfortunately, as noted above savings and investment rates in Pakistan are unusually low, averaging annually 14.8 percent and 19.6 percent of Gross National Product during the five years ended 1995-96 (Khan, 1997). At these low rates of savings and investment, it would not be possible to support future economic growth of 7 percent a year. Seven- percent growth is socially necessary, in view of the country's neglected infrastructure system and low levels of investment in social sectors.

The savings/investment relationships are clearly the crucial factors affecting the country's economic destiny at this point in time.

Macroeconomic Linkages

Because of the importance of defense expenditures in the government's budget, any discussion of macroeconomic patterns and linkages would be incomplete without the explicit introduction of this variable (Looney 1994, 1994a).

- Here the main linkages between defense expenditures and economic activity are assumed to be both direct (as with Keynesian demand creation) and indirect (through possible deficit induced crowding out of private activity and/or diversion of private savings to the public sector.
- The model captures the fundamental dilemma facing Pakistani policy-makers. Looked at in isolation, defense expenditures have tended to positively influence the economy. However if these expenditures are funded with increased levels of deficit financing, the subsequent crowding out of private investment may actually result not only in increased inflation, but, more importantly, in a net negative impact on the economy. The inability of non-defense expenditures other than infrastructure to impact positively on the economy has only compounded this dilemma.
- Finally the concern of external creditors over the country's high defense burden will in all likelihood increasingly constrain allocations to the military.

Prospects for the Future

Realistically Pakistan's fiscal options for the foreseeable future are likely to be narrowly constrained by the International Monetary Fund (IMF), with the most recent package, anticipated at around $1.6 billion, to be approved before the end of October 1977.

- It should be noted however the past record of IMF programs in the country has not been good, with bad feelings occurring on both sides (Ijaz, 1996).
- During the past decade Pakistan has entered into six IMF programs, but each was aborted mid-term when the country failed to meet its key conditions.
- Part of the problem has been widespread tax evasion which has led revenues to trail behind collection targets, with the budget deficit staying above estimates (Bokhari, 1997a).
- Clearly, to restore a stable growth path, the country will have to chart out medium term objectives that are realistic and consistent.

Policy Constraints and Objectives

As a starting point the macroeconomic relationships outlined above were used to assess the extent to which the following set of objectives are attainable over the period to the year 2000 and under what conditions. These include

1. A stable rate of GDP growth of between 6.0 percent and 7.0 percent per annum—this is in line with the average rate of growth since 1976
2. Employment growth of 2.8 percent to 3.1 percent—around the rate of growth of population and consistent with past rates of job creation
3. Inflation 5 percent or lower—somewhat below the historical range of 7–8 percent
4. Foreign borrowing to expand at a rate slower than the general expansion in economic activity; that is, around 5 percent or less
5. Defense expenditure to decline to around 4–5 percent of GDP—down from the 6–7 percent range in the late 1980s early 1990s.
6. Government deficits to fall to 3–4 percent of GDP—down from the 6 percent figure reached in the early 1990s
7. A general expansion in the share of savings in GDP up toward the range of 18–20 percent—typical values for countries at Pakistan's stage of development
8. An expanded share of private investment in GDP

Policy Simulations

Using a policy oriented macroeconomic model of the economy, several policy packages were examined in terms of their ability to improve the country's economic fortunes. The main findings of these simulations are summarized in Figure 6.

In summing up, the fiscal pattern that developed in Pakistan during the 1980s and extending into the 1990s is not sustainable. Over-expansion in expenditures, both for defense and nondefense purposes, together with sluggish revenues and excessive foreign borrowing have created a situation in which further growth will be increasingly constrained by debt servicing, inflation, and shortages of domestic savings for private investors.

However, given the complex nature of defense expenditures in both stimulating and suppressing growth, budgetary reductions in this area in and of themselves are unlikely to improve the country's economic performance. In fact, rapid reductions in defense are likely to impair the situation even further. On the other hand, modest efforts in tax reform are by far the most effective means at restoring fiscal stability (Khan, 1989). The optimal policy mix is one of tax reform together with defense expenditures expansion that is constrained in the 2.5 percent range. Unforeseen events aside, this package would enable the country to meet the goals established by itself and its major creditors in restoring a rapid, self-sustaining growth in an environment characterized by a declining defense burden.

Implications

The results summarized above are suggestive of the country's future macroeconomic environment. They show that the country has, through fiscal reforms, the potential of sustaining a relatively high rate of economic expansion throughout the 1990s. Combining the fiscal simulations summarized above with an (admittedly subjective) estimate of their likely occurrence, the country has, in most likelihood, a probability of around 40 percent of sustaining a strong economic expansion through the remainder of the 1990s (Figure 6).

A broader issue is whether this expansion is broad-based enough and sustainable to the point that the country might evolve into a dynamic South Asian Tiger. The Japanese like to compare Asia's economic development to a formation of flying geese with Japan, whose economic miracle started in the 1950s at its head. Japan was followed by Hong Kong, South Korea Singapore and Taiwan. In the 1970s, Indonesia, Malaysia and Thailand joined the flock. In the 1980s came China. An obvious question is whether the latter 1990s will see some of the countries of South Asia join the flock (Williamson, 1997).

In this regard, the present Southeast Asian Tigers have a number of characteristics that set them apart from Pakistan and most other developing countries. These include the following:

1. More rapid output and productivity growth in agriculture
2. Higher rates of growth of manufactured exports
3. Earlier and steeper declines in fertility
4. Higher growth rates of physical capital supported by higher rates of domestic savings
5. Higher initial levels of growth rates of human capital
6. Generally higher rates of productivity growth
7. Declining income inequality and reduced poverty

Although Pakistan's overall economic growth rates have been roughly comparable to those of the Southeast Asian (Singapore, Malaysia, South Korea, and Thailand) countries (Table 5), it is apparent that the country has not been able to lay the foundation necessary for high and sustained growth. In particular

1. The country's savings rate is one of the lowest in the world
2. Export performance has been erratic
3. Manufacturing has not shown an ability to grow at a faster rate then the overall economy
4. Government consumption accounts for a relatively high share of the GDP
5. The country's population growth rate remains relatively high
6. As opposed to the Southeast Asian countries, Pakistan would be beginning its phase of high growth with an extremely high debt ratio
7. By most measures, Pakistan's military expenditures are considerably above those in Southeast Asia

Figure 6

Pakistan: Fiscal Options and Prospects to the Year 2000

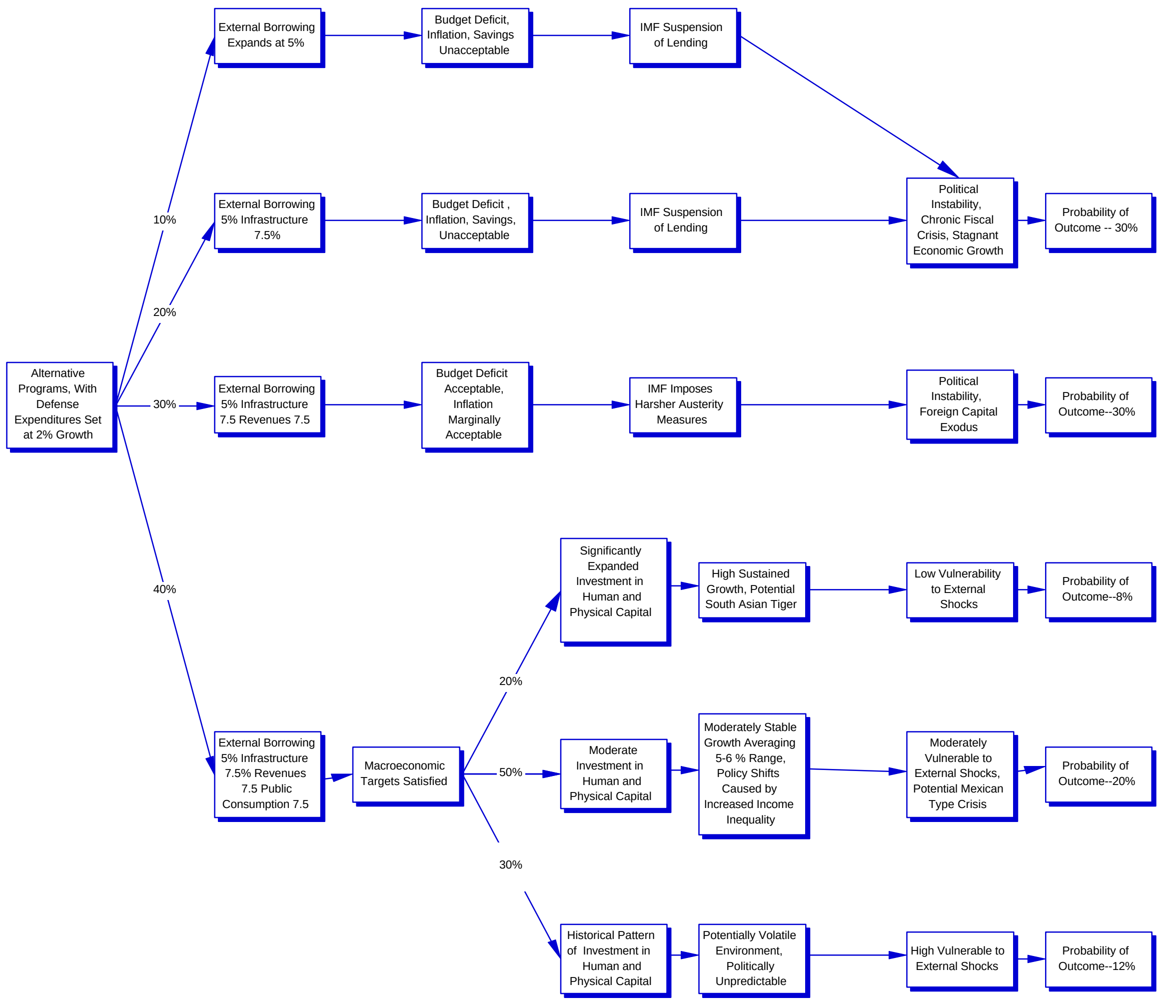


Table 5
International Comparisons of Economic and Social Performance

Measure	Region			
	Total	SE. Asia	S. Asia	Pakistan
Economic Performance (% Growth)				
Gross Domestic Product, 1970–80	4.9	8.2	4.1	4.9
Gross Domestic Product, 1980–91	2.8	7.5	5.2	6.1
Investment, 1970–80	6.5	10.0	7.3	3.7
Investment, 1980–91	0.3	7.8	4.0	5.6
Exports, 1970–1980	4.0	7.9	2.3	0.7
Exports, 1980–91	4.7	10.7	7.9	9.9
Government Expenditures, 1970–79	8.1	9.4	5.9	7.4
Government Expenditures, 1981–91	0.8	4.9	5.0	7.0
Population, 1970–80	2.6	2.2	2.4	3.1
Population, 1980–91	2.5	1.8	2.2	3.1
Economic Structure (% GDP)				
Investment, 1970	21.7	28.0	17.3	16.0
Investment, 1991	20.5	37.8	20.7	19.0
Savings, 1970	18.6	20.3	13.7	9.0
Savings, 1991	14.0	36.3	14.7	12.0
Private Consumption, 1970	69.1	67.8	76.0	81.0
Private Consumption, 1991	72.2	52.5	73.7	75.0
Exports, 1970	22.7	43.3	12.3	8.0
Exports, 1991	28.5	83.3	17.7	16.0
Resource Balance, 1970	-2.7	-7.5	-3.7	-7.0
Resource Balance, 1991	-6.8	-1.5	-6.0	-7.0
Government Consumption, 1970	13.8	12.3	10.3	10.0
Government Consumption, 1991	13.9	11.5	11.7	13.0
Manufacturing, 1970	14.2	17.3	16.0	16.0
Manufacturing, 1991	15.2	28.0	16.3	17.0
Infrastructure Investment (% Growth)				
Paved Roads, 1970–80	8.6	8.5	5.6	4.4
Paved Roads, 1980–90	3.0	4.8	5.3	8.6
Irrigated Land, 1970–80	4.5	2.5	1.6	1.3
Irrigated Land, 1980–90	2.4	1.5	1.0	1.5
Electric Generating Capacity, 1970–80	8.9	11.8	6.6	8.3
Electric Generating Capacity, 1980–90	6.2	7.9	10.1	10.0

Table 5 continued
International Comparisons of Economic and Social Performance

Measure	Region			
	Total	SE. Asia	S. Asia	Pakis
Debt (%)				
External Debt/Exports 1980	152.4	90.7	156.1	208.8
External Debt/Exports 1991	392.3	65.4	250.4	244.9
External Debt/GDP 1980	40.9	34.2	33.5	42.4
External Debt/GDP 1991	82.5	33.7	50.7	50.1
Debt Service/Exports, 1980	17.3	15.0	13.1	17.9
Debt Service/Exports, 1991	21.0	9.5	21.9	21.1
Military (Average % Share)				
Defense Expend./Budget, 1970–80	15.2	22.0	17.7	29.5
Defense Expend./Budget, 1980–91	16.1	18.9	17.0	26.2
Arms Imports/Total Imp., 1970–80	8.5	2.4	5.3	8.5
Arms Imports/Total Imp., 1980–91	17.7	1.3	6.9	6.9
Defense Expend./GDP, 1970–80,	5.6	9.1	7.0	6.1
Defense Expend./GDP, 1980–91	5.3	4.5	4.1	6.2
Armed Forces/1000 Pop., 1970–80	7.1	10.8	3.3	6.5
Armed Forces/1000 Pop., 1980–91	8.0	12.2	3.4	6.3
Social				
Population per Physician, 1970	15470.4	4047.5	5033.3	4310.0
Population per Physician, 1990	10570.2	2472.5	2700.0	2940.0
Life Expectancy (years) 1991	60.4	71.0	63.3	59.0
Illiteracy (%) 1991	37.4	11.0	43.0	65.0
Malnourishment (%), 1991	25.4	25.0	51.0	57.0
Education (% Relevant Age Group in School)				
Primary School, 1970	71.9	94.5	70.7	40.0
Primary School, 1990	87.5	99.0	80.3	37.0
Secondary School, 1970	20.8	34.8	28.7	13.0
Secondary School, 1990	39.8	61.0	46.7	22.0
Tertiary School, 1970	8.1	11.0	4.5	4.0
Tertiary School, 1990	10.8	17.5	3.5	3.0
Primary Pupil/Teacher Ratio, 1970	38.5	38.3	41.0	41.0
Primary Pupil/Teacher Ratio, 1990	35.4	25.0	51.0	41.0

Sources: Economic/Social, World Bank. Military, United States Arms Control and Disarmament Agency.

Most important, the country has seriously neglected the development of human capital. The data paint a stark picture (ul-Haq, 1997a):

- Two thirds of Pakistan's adult population and over three quarters of adult women are illiterate.

- Basic health facilities are not available to over half the population.

- Sixty-seven million people lack access to safe drinking water while eighty-nine million are without elementary sanitation facilities.

- A quarter of newborn babies are malnourished.

The unequal distribution of human capital in turn has created an income distribution much more unequal that found in Southeast Asia. Most analysts feel that the success of the Southeast Asian economies is liked to their initial, equitable distribution of income and assets.

Given the budgetary constraints that the government is likely to be faced with during the remainder of the decade, it is difficult to see how the country could significantly improve its social infrastructure. Without these human assets and capabilities, the country will be unable to achieve the productivity increases necessary to transform itself, certainly in the near future, along the lines of the Southeast Asian model.

Conclusions

It is remarkable that despite a troubled and crisis prone political history, Pakistan has managed to make significant strides in several spheres, including rapid economic growth, and industrial development. Much of this has occurred despite and not due to official policy or action, encouraging the belief among most Pakistanis that less government is the key to a better future.

Returning to the questions posed at the start of this paper:

- While it is unlikely that the country will become a South Asian Tiger in the near future, one can not rule this out in the longer term.
- Human capital deficiencies aside, in many respects Pakistan is better positioned now to move ahead with rapid economic development. IF the cold war's end forced difficult adjustments, it also opened new opportunities. Its situation next to the newly independent and resource-rich region of central Asia means that Pakistan could become of central importance to this area (Lodhi, 1997).
- The majority of the country's population remains poor no doubt largely because of limited economic freedom. Government controls restricting access to opportunity, together with a budgetary process dominated by the country's elite and biased against human capital development, have prevented the spread of economic prosperity to the mass of the population.

Less certain is the extent democracy can be sustained in light of the massive economic, and social difficulties the country currently faces. If the current government can press ahead with broad based reforms that provide more economic freedom (Messick, 1996), the longer run prospects for democracy may improve. Robert Barro (1991) has examined the links between economic freedom, development and democracy. His findings suggest that:

- The favorable elements for growth include small distortions of market prices, an inclination and ability of the government to maintain the rule of law, high levels of health and education, low government spending on consumption and a low fertility rate. If these variables and the level of per-capita income are held constant, the overall effect of more democracy on the growth rate is moderately negative.

- There is some indication that more democracy raises growth when political freedom is low, but depresses growth once a moderate amount of freedom has been attained.

- There is a stronger linkage between economic development and the propensity to experience democracy. Specifically non-democratic countries that have achieved high stands of living—measured by real per capita GDP, life expectancy and schooling—tend to become more democratic over time. Examples include Chile, South Korea and Taiwan.

- Conversely, democratic countries with low standards of living tend to lose political rights. Examples included the newly independent African states in the 1970s.

In Pakistan’s case, high growth during the Zia years may have contributed the desire for greater participation. In turn, this no doubt led to the improved democracy under B. Bhutto and greater economic freedom under N. Shariff. Improving the position and efficiency of the private sector offers a major opportunity to encourage that segment of the economy to expand its saving and investment. In addition, finding a greater role for the private sector in the politics of the country will broaden the state's legitimacy.